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**FISCAL IMPACT STATEMENT**

**LS 6272**

**BILL NUMBER:** SB 11

**NOTE PREPARED:** Nov 7, 2004

**BILL AMENDED:**

**SUBJECT:** Elimination of Inheritance Tax.

**FIRST AUTHOR:** Sen. Ford

**BILL STATUS:** As Introduced

**FIRST SPONSOR:**

**FUNDS AFFECTED:** ☒ **GENERAL**  
☒ **DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides that the Inheritance Tax does not apply to the transfer of property interests from an individual who dies after June 30, 2005. It provides that the Indiana Estate Tax does not apply to the transfer of property interests from an individual who dies after December 31, 2004. It also provides that the Indiana Generation Skipping Transfer Tax does not apply to a generation skipping transfer occurring after December 31, 2004.

**Effective Date:** January 1, 2005 (retroactive); July 1, 2005.

**Summary of Net State Impact:** Under the bill the state will no longer receive revenue from the Inheritance Tax beginning in FY 2007. The bill is also expected to increase state General Fund expenditures on county Inheritance Tax replacement at the same time. The impact of the bill on state revenues and expenditures is summarized in the table below.

| Inheritance Tax Revenues | Add'l. State Expenditures for County Replacement | Net Increase (Decrease) |
|--------------------------|--|-------------------------|
| (\$120 M)                | (\$7.4 M)  | (\$127.4 M)             |

**Explanation of State Expenditures:** *Department of State Revenue:* If the Inheritance Tax is repealed, there could be a savings to the state from a reduction in staff of the Inheritance Tax Section of the Department of State Revenue. The September 7, 2004, state staffing table indicates that the Inheritance Tax Division has 14 full-time employees with an annual salary of \$399,100. Since staff will be needed to process returns during

the phaseout of the Inheritance Tax, a specific savings due to staff reductions could not be estimated.

*County Inheritance Tax Replacement:* The bill could increase expenditures from the state General Fund for county Inheritance Tax replacement by approximately \$7.4 M annually beginning in FY 2007.

**Explanation of State Revenues:** *Summary:* The bill would eliminate an estimated \$120 M in annual Inheritance Tax revenue to the state beginning in FY 2007. The bill also repeals the Indiana Estate Tax and the Generation Skipping Transfer Tax. It is estimated that these two changes will not have a significant impact on state revenues.

*Background:* The bill repeals the:

- (1) Inheritance Tax on property transfers by a decedent who dies after June 30, 2005.
- (2) Estate Tax on the estate of a decedent who dies after December 31, 2004.
- (3) Generation Skipping Transfer Tax on property transfers occurring after December 31, 2004.

Inheritance Tax: Since the Inheritance Tax must be paid within 12 months after the decedent's death (within 9 months to receive the 5% early payment discount), the bulk of the impact of the first year's credit (equal to 20%) would not be experienced until FY 2007. The estimated impact of repealing the Inheritance Tax is based on the Revenue Technical Committee's FY 2005 forecast (updated January 12, 2004). This forecast estimates FY 2005 Inheritance Tax at \$120 M. Recent quarterly revenue from the Inheritance Tax confirms this forecast total. Quarterly Inheritance Tax revenue to the state averaged about \$33 M during FY 2004. However, quarterly revenue dropped to about \$30 M during the 1<sup>st</sup> quarter of FY 2005. The estimated revenue loss assumes that Inheritance Tax revenues would remain relatively constant in the future, absent repeal of the tax.

Estate Tax: The repeal of the Estate Tax will not have a fiscal impact since the tax will be eliminated beginning in 2005 due to federal law changes. Under current statute, Indiana Estate Tax is owed on the assets of an estate if: (1) federal Estate Tax is owed on the estate; and (2) the Indiana portion of the *state death tax credit* for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. So, the Indiana Estate Tax is equal to the difference between the state death tax credit and the Indiana Inheritance Tax. However, under the federal *Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)*, the state death tax credit will be eliminated for estates of decedents who die after December 31, 2004. At this point the Indiana Estate Tax will no longer be collected because the state death tax credit will no longer apply. The federal Estate Tax will be eliminated in 2010. It is important to note that the provisions of the federal legislation repealing the federal Estate Tax are scheduled to sunset at the end of 2010. As a result, the 2001 federal Estate Tax provisions will automatically be reinstated on January 1, 2011. The Congress has failed to enact legislation to extend the repeal provisions or make them permanent.

Generation Skipping Transfer Tax: Like the Indiana Estate Tax, the Indiana Generation Skipping Transfer Tax is also linked to the federal version of the tax. The federal Generation Skipping Transfer Tax is also repealed in 2010 under *EGTRRA*. From FY 1993 to FY 2003, this tax reportedly generated no revenue. The tax did generate \$31,254 in FY 2004.

### **Explanation of Local Expenditures:**

**Explanation of Local Revenues:** It is estimated that repeal of the Inheritance Tax will result in a net revenue loss to counties totaling about \$2.9 M annually. The county share of Inheritance Tax revenue is estimated to

total about \$10.3 M annually assuming revenue would otherwise remain relatively constant. State expenditures for county Inheritance Tax replacement will total approximately \$7.4 M annually after the repeal of the tax.

Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. Counties are guaranteed a statutorily determined amount as determined by the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years.

Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure. From FY 2000 to FY 2003, counties exceeded their guarantee amounts by an average of \$4.7 M annually with shortages subject to replacement averaging about \$200,000 per year. The total annual guarantee to counties is \$7.4 M. As a result, some reductions in county revenue exceeding the guarantee amount will not be replaced by the state.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** State Revenue Forecast (January 12, 2004); Inheritance Tax Quarterly Reports.

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